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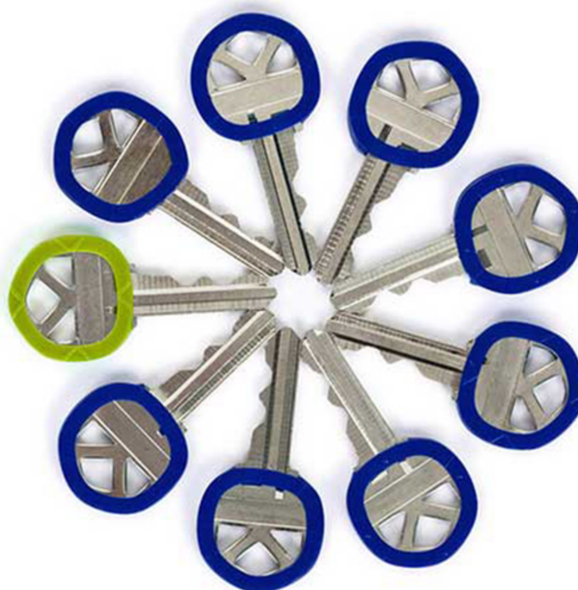

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IRS Request Comments on Revenue Procedure 94-59

The IRS' Large Business and International Division (LB&I) is requesting comments from large corporate taxpayers currently utilizing the procedures under Revenue Procedure 94-69 to disclose changes in tax positions after the opening of an examination.

Originally, Revenue Procedure 94-69 ("Rev. Proc. 94-69") allowed taxpayers subject to the former Coordinated Examination Program to show additional tax or make disclosures to avoid imposition of accuracy related penalties for negligence, disregard of rules or regulations or substantial understatement of income.[1] After the elimination of the Coordinated Examination Program, Revenue Procedure 94-69 was applied to taxpayers under the Coordinated Industry Case Program ("CIC"), which allowed taxpayers in a continuous examination cycle to utilize these procedures. In 2019,

[1] *See* IRC §§ 6662(b)(1), 6662(b)(2)

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the IRS replaced CIC with the Large Corporate Compliance Program ("LCC") effective for audits for tax years 2017 and later.

The IRS announced in May 2019 that Rev. Proc. 94-69 will continue to apply to any taxpayer that is in both CIC, for tax years prior to 2017, and the new LCC program for the 2017 tax year. Rev. Proc. 94-69 does not apply to LCC taxpayers that were not previously CIC taxpayers, or CIC taxpayers that did not have an open CIC examination as of May 2019.

LB&I is considering obsoleting Rev. Proc. 94-69 because it is only available to a small group of large corporate taxpayers, creating a disparity among the LB&I filing population who must use the qualified amended return process. In addition, LB&I finds that Rev. Proc. 94-69 does not support the broader tax administration effort to improve accuracy and reliability of returns at the time of filing. LB&I is requesting taxpayers submit comments on this issue. Commenters should take in account the issues with Rev. Proc. 94-69 identified by the IRS and the availability of existing avenues for adequate disclosures that are currently utilized by all other taxpayers. The IRS requests that comments by October 19, 2020 to lbi.lcc.program@irs.gov.

United States v. Sanmina and Work-Product Protection

In *United States v. Sanmina*,[2] the Ninth Circuit Court of Appeals considered Sanmina Corporation's (hereinafter "Taxpayer") appeal of a federal district court's decision that upheld the enforcement of an IRS summons for in-house memoranda on the grounds that Taxpayer had waived its work-product protection and attorney-client privilege. The Ninth Circuit affirmed in part and reversed in part the district court's decision, finding that Taxpayer had waived its attorney-client privilege but had not waived its work-product protection, except for the factual content of the memoranda.

The case arose out of a dispute between the IRS and Taxpayer about a worthless stock deduction Taxpayer claimed on its federal tax return for the 2008 tax year. After Taxpayer reported the deduction, the IRS examined Taxpayer's 2008 through 2010 tax years. As part of the examination, Taxpayer provided the IRS with a valuation report prepared by an external law firm, which the report's stated purpose was to provide an analysis and estimate of the value of Taxpayer subsidiary's stock. The valuation report was labeled as attorney-client privilege and referred in a footnote to two memoranda created by Taxpayer's in-house counsel (hereinafter "the memos"). The memos were shared outside of Taxpayer with only two accounting firms and the external law firm that conducted the valuation report for the purpose of receiving tax advice related to the worthless stock deduction.

The IRS filed a petition to enforce the summons for the memos and the district court ordered Taxpayer to show cause for not enforcing the summons. At first, the district court held that the memos were protected by privilege. The IRS appealed and the case was remanded back to the district court for an in-camera review to determine if the memos were actually privileged and whether the privilege was waived. The district court affirmed the earlier finding that the memos were protected by attorney-client privilege and work-product doctrine but found that these were waived when Taxpayer disclosed the memos to the external law firm, not for the purpose of receiving legal advice but in order to obtain a valuation opinion. According to the Court, the point of waiver occurred when Taxpayer provided the memos to the external law firm to produce the valuation report that they planned to turn over to the IRS. The court relied on Ninth Circuit precedent *Weil v. Investment/Indicators, Research & Management, Inc.* to conclude that both work-product protection and attorney-client privilege had been waived, observing that Taxpayer cannot use privileged attorney communications as a sword and invoke privilege to shield it from discovery.[3] Taxpayer appealed the district court's ruling to the Ninth Circuit.

The Ninth Circuit began its analysis by reviewing the foundations of attorney-client privilege as a protection of confidential communications between attorneys and clients for the purpose of giving legal advice. The Court observes that attorney-client privilege may extend to communications with third parties who have been engaged to assist the

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[2] *United States v. Sanmina Corp. & Subs.*, No. 8-17036 (9th Cir. Aug. 7, 2020)
[3] *Weil v. Investment/Indicators, Research & Management, Inc.*, 647 F.2d 18 (9th Cir. 1981)

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attorney in providing legal advice as well as in situations where third parties are acting as agents.[4] The key determinant in these situations is whether the communications concern legal advice.

In addition to these considerations, the Court pointed out that there are several ways in which a party may waive the privilege, either expressly or impliedly. Express waiver occurs when a party discloses privileged information to a third party who is not bound by the privilege or shows disregard by making the information public.[5] By contrast, implied waiver rests on a fairness issue and generally involves circumstances in which a party attempts to use the privilege as both a sword and a shield by asserting claims utilizing privileged information and then preventing discovery by invoking the privilege.[6]

Against this precedential backdrop, the Court considered the question of whether Taxpayer expressly waived its attorney client privilege for the memos by sharing them with the external law firm. The Court concluded that the answer turned on whether Taxpayer shared the memos for the purpose of legal advice. Relying on the district court's factual conclusion as not clearly erroneous, the Ninth Circuit found that Taxpayer disclosed the memos for tax compliance purposes and thereby waived the privilege.

Next, the Court addressed the question of whether Taxpayer waived its work-product protection. Work-product protection is a qualified privilege that protects documents and tangible things from discovery that are prepared by a party or a party's representative in anticipation of litigation.[7] The work-product doctrine functions to protect the mental processes or the attorney, providing a privileged area within which a client or his representative can analyze and prepare his client's case.[8] Like attorney-client privilege, work-product protection can be waived by revealing the protected material or putting the work-product at issue during litigation.[9]

While work-product can be waived like attorney-client privilege, courts recognize an important distinction between attorney-client privilege and work-product protection in rules concerning waiver by disclosure.[10] Disclosure to a third party does not necessarily waive work-product protection. Disclosure only waives work-production protection when it is made to an adversary or the disclosure has substantially increased the opportunity for potential adversaries to obtain the information.[11]

Applying this law to the current case, the Ninth Circuit examined whether Taxpayer's disclosure of the memos to the external law firm qualifies as a disclosure to an adversary or a potential conduit to an adversary. In answering the first question, the Court determined that disclosing the memos did not qualify as disclosure to an adversary. Both the government and Taxpayer agreed that the external law firm was not an adversary nor a potential adversary of Taxpayer. The Court concluded that while sharing the memos with the external law firm may render the external law firm a third party for purposes of attorney-client privilege, it does not vitiate work-product protection.

Next, the Court considered whether Taxpayer had implicitly waived its work-product protection by disclosing information in a manner inconsistent with the maintenance of secrecy against an adversary.[12] The Court considered the totality of the circumstances and found that the reference to memos in the valuation report was inconsistent with its goal of maintaining secrecy.

The court, however, concluded that the scope of the implied waiver should not encompass the legal opinion work-product found in the two memos and tailored the waiver accordingly. As a result, Taxpayer will not have to produce the legal analysis of its in-house counsel in response to the government's summons. The Ninth Circuit ordered disclosure of only the factual content of the memoranda on which the valuation report relies and remanded for the district court to determine the specific portions of the memoranda that should be disclosed to the IRS.

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[4] Richey, 632 F.3d at 566; *United States v. Landof*, 591 F.2d 36 , 39 (9th Cir. 1978).
[5] *Bittaker v. Woodford*, 331 F.3d 715 , 719 (9th Cir. 2003).
[6] *Id.* at 719
[7] *Admiral Ins. Co. v. U.S. Dist. Ct.*, 881 F.2d 1486,
[8] *United States v. Nobles*, 95 S. Ct. 2160 , 45 L. Ed. 2d 141 (1975)
[9] *Id.* at 239
[10] *Transamerica Computer Co., Inc. v. Int'l Bus. Machines Corp.*, 573 F.2d 646 , 647 n.1 (9th Cir. 1978)
[11] Charles Alan Wright & Arthur R. Miller, Federal Practice & Procedure§ 2024 (3d ed. 2020)
[12] *In re Martin Marietta Corp.*, 856 F.2d 619, 625-26 (4th Cir. 1988)

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IRS Releases a Chief Counsel Advisory Memorandum on Repetitive Audits

The IRS Office of Chief Counsel released a memorandum ("the Memorandum")[13] that considered whether IRS exam can audit a net operating loss ("NOL") carryforward from a tax year in which the underlying loss was previously audited by Exam and allowed by IRS Appeals. The Office of Chief Counsel concluded that IRS exam could not audit these NOL carryforwards because doing so would amount to a repetitive audit, which is prohibited under Internal Revenue Code Section 7605(b).[14]

The Facts

The taxpayer engaged in the business of investment management. Taxpayer purchased a wine vineyard and claimed losses from the vineyard for several years. The Internal Revenue Service ("IRS" or "Service") examined the taxpayer's return for certain years in which the taxpayer claimed losses from his vineyard activity and determined that the taxpayer's vineyard was a hobby activity. The IRS issued a notice of proposed adjustment ("NOPA") disallowing, pursuant to Section 183, all expenses and depreciation related to the taxpayer's vineyard activity for the years under audit. The Taxpayer submitted a protest of this determination to the Office of Appeals. The Office of Appeals applied the nine-factor test prescribed in Treas. Reg. §1.183-2(b), fully sustaining the taxpayer's position for the years under audit.

The IRS later audited the taxpayer for a subsequent year. This time the IRS examined whether the taxpayer could utilize an NOL carryforward originating from losses incurred by the vineyard during the years previously examined by the IRS and allowed by IRS Appeals. In addition, the IRS examined (and challenged) the losses the taxpayer claimed from the vineyard in the subsequent year. Taxpayer argued that the examination of its NOL carryforward was a repetitive audit in violation of I.R.C. § 7605(b).

Law and Analysis

The analysis by IRS Office of Chief Counsel in the Memorandum starts by examining the statutory language of Section 7605(b), which provides that: "no taxpayer shall be subjected to unnecessary examination or investigation and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary." The Office of Chief Counsel identified two restrictions in the statute:

1. Unnecessary examinations or investigations and
2. More than one inspection of a taxpayer's books of account for a tax year.

The Memorandum noted that courts have construed these provisions by applying the *pari materia* canon of statutory construction, reading the prohibition against the second inspection as operating in tandem with the restrictions in the first clause. In *United States v. Schwartz*, the Fifth Circuit Court of Appeals noted the first clause of Section 7605(b) was the driving purpose behind the statute.[15] The Memorandum noted that the Fifth's Circuit's observation in Schwartz is bolstered by the legislative history of Section 7605(b) and its predecessors. According to the House Report to the forerunner to Section 7605(b), the aim behind the provision, when it was introduced as part of the Revenue Act of 1921, was to relieve taxpayers from unnecessary annoyance caused by onerous and superfluous examinations.[16]

The Memorandum pointed out that, in applying the restrictions of Section 7605(b), courts have been reluctant to restrict legitimate investigations by the Service. Courts have indicated that the provision was not designed to prevent an IRS Agent from diligently performing his statutory duty to collect the revenues.[17] In fact, the Memorandum recognized that the grant of authority to the IRS to conduct examinations has been construed liberally.[18]

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[13] Chief Counsel Memorandum 20202501F (May 7, 2020)
[14] I.R.C. §7605(b)
[15] *United States v. Schwartz*, 469 F.2d 977, 983 (5th Cir. 1972)
[16] See H.R. Rep. No. 67-350, at 16 (1921)
[17] *Benjamin v. Commissioner*, 66 T.C. 1084, 1098 (1976)
[18] *DeMasters v. Arend*, 313 F.2d 79, 87 (9th Cir. 1963)

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In spite of the Service's broad audit authority, the Memorandum concluded that the facts in the current case qualify as an exceptional circumstance contemplated by the drafters of Section 7605. The Memorandum distinguished a potentially similar case previously before the United States Tax Court from the facts of the case in the Memorandum and used the two situations to illustrate the difference between a legitimate and an illegitimate recurrent examination.[19]

In *Digby v Commissioner*, the IRS had audited a taxpayer for the 1987 tax year, ultimately allowing losses that he received as a flow-through from an S corporation that he owned.[20] A different agent subsequently audited the taxpayer's 1988 return and disallowed the flow-through losses for 1988 and also disallowed the taxpayer's 1987 flow-through losses due to a lack of basis. In *Digby*, the Tax Court held that an inspection of the taxpayer for a later year, 1988, did not constitute a second inspection of the taxpayer for 1987. According to the Tax Court, Section 7605(b) is concerned with a second inspection for the same taxable year and an examination of a different taxable period that affects an already examined year does not qualify as a second inspection.

The Memorandum found that the circumstances in the current case were vastly different from those in *Digby*. In the current case, the NOL carryforwards were with respect to the taxpayer's vineyard activity in prior years and the issue of whether the taxpayer's vineyard activities was a for-profit business or hobby activity for those years had been previously sustained at IRS Appeals. Thus, the challenge by the IRS to the validity of the taxpayer's NOL carryforwards was the kind of repetitive audit that Section 7605(b) was designed to prevent and therefore the second audit of the taxpayer's prior years is prohibited.

IRS Releases Chief Counsel Advisory Memorandum on Section 965 and the period of adjustment for partnership under TEFRA and BBA

The IRS Office of Chief Counsel released a memorandum that addressed the period of limitations for adjustments related to Section 965 for:

1. Partnerships subject to the Tax Equity and Fiscal Responsibility Act audit procedures ("TEFRA");
2. Partnerships subject to the Bipartisan Budget Act of 2015 centralized partnership audit regime ("BBA"); and
3. Partnerships not subject to consolidated audit procedures.

Background on Section 965

Section 965 was amended by Section 14103 the Tax Cuts and Jobs Act (the "TCJA"),[21] which was enacted on December 22, 2017. In general, Section 965 requires United States shareholders
to pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States. A specified foreign corporation means either a controlled foreign corporation, as defined under Section 957 ("CFC") , or a foreign corporation (other than a passive foreign investment company, as defined under Section 1297, that is not also a CFC) that has a United States shareholder that is a domestic corporation. Section 965 applies in the case of the last taxable year of a deferred foreign income corporation that begins before January 1, 2018.[22]

The memo outlines three broad categories of adjustments that could be made to Section 965 amounts. The three broad categories of adjustments are:

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[19] *See Digby v Commissioner*, 103 T.C. 441 (1994)
[20] *Id.*
[21] Pub. L. No. 115 -97.
[22] Under Section 965(d)(l) the term "deferred foreign income corporation" means, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder which has accumulated post-1986 deferred foreign income (as of the date referred to in paragraph (I) or (2) of subsection (a)) greater than zero.

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1. Adjustments to a Section 965(a) inclusion amount;
2. Adjustments to Section 965(c) deductions;[23] and
3. Adjustments to foreign tax amounts.

Overview of Code Sections for Assessment

The memo provides an overview of certain exceptions to the 3-year assessment statute of limitations set forth in Section 6501(a), which the memo states could potentially be applicable to an assessment of a Section 965 liability.

The memo addresses the period for assessment set forth in Section 965. Section 965(k) provides that, notwithstanding Section 6501, the limitation on the time period for the assessment of the net tax liability under Section 965 shall not expire before the date that is 6 years after the date of the filing of the US shareholder's tax return reporting the Section 965 tax liability.

Section 6501(e)(1)(C) provides that if the taxpayer omits from gross income an amount properly includible therein under Section 951(a) (i.e. subpart F income), the tax may be assessed, or a proceeding in court for the collection of such tax may be done without assessing, at any time within 6 years after the return was filed. Unlike the period in Section 965(k), this provision extends the period of assessment to six-year for the entire tax liability reportable on the return.

Additionally, Section 6501(e)(1)(A), provides an extended six-year limitations period for taxpayers that omit from gross income an amount greater than 25 percent of gross income reported on their return. It must be an omission of gross income; an overstatement of deductions does not qualify.[24] In addition, items that are adequately disclosed are not included in the calculation of omitted items.[25]

Also, the memo notes that Section 6501(c)(8)(A) states the assessment statute of limitation does not expire any earlier than three years after the required information about certain cross-border transactions or foreign assets is actually provided to the Secretary by the person required to file the return. The scope of the extension is limited if a failure to provide information on cross-border transactions or foreign assets is shown to be due to reasonable cause and not willful neglect. In cases in which a taxpayer establishes reasonable cause, the assessment statute of limitations is suspended only for the item or items related to the failure to disclose.[26]

TERA, BBA and the Statute of Limitations on Assessment/Adjustment

The last section of the memo briefly summarizes the TERA and BBA audit regimes and analyzes the way the adjustment periods of these procedural architectures interact with Section 965 adjustments.

TEFRA

TEFRA rules generally apply to all partnerships' tax years beginning before January 1, 2018, except for those small partnerships that meet a small partnership exception.[27] Under TEFRA, adjustments to partnership items are made at the partnership level. A partnership item is any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations provide that the item is more appropriately determined at the partnership level.[28]

For TEFRA partnerships, Section 6229(a) sets forth a minimum 3-year period for assessing any income tax that is attributable to any partnership item or affected item. The 3-year period runs from the later of date the partnership

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[23] IRC § 965(c)
[24] Colony, Inc. v. Commissioner, 357 U.S. 28 (1958).
[25] IRC § 6501(e)(1)(B)(ii).
[26] IRC § 6501(c)(8)(A)
[27] IRC §§ 6031(a), 6231(a)(1)(B).
[28] IRC § 6231(a)(3) ; Treas. Reg. § 301.6231(a)(3)-1

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return was filed or the due date.[29] A partner's period of limitations under Section 6501 cannot expire before the minimum period in Section 6229(a).[30] This minimum period can be extended under certain conditions.

Because Section 6229 has a minimum period within which no partner's Section 6501 period can expire, if the partner's Section 6501 period of limitations is open for a reason unrelated to Section 6229 (for example, under Section 6501(c)(8) or (e)(1)(C)), assessments may be made against that partner for any tax attributable to partnership items and affected items.

Under Section 965, the IRS may adjust Section 965(a) inclusion amounts and Section 965(c) deduction amounts reportable by a partnership. These are partnership items of the partnership. I.R.C. § 6231(a)(3); Treas. Reg. § 301.6231(a)(3). Any adjustments to these partnership items would affect the corresponding Section 965(a) inclusions and corresponding Section 965(c) deductions and foreign tax amounts reported by the partners. The Section 965(a) inclusion amount and Section 965(c) deduction amount reported by the partnership may be adjusted for the taxable year for which those amounts are required to be reported so long as either the Section 6229 minimum period applies or the partner reported an item that would be affected by those adjustments in a year in which the partner's period of limitations on assessment of those items is open.

BBA

The BBA audit procedures pick up where TEFRA left off, applying to any partnership that does not elect out for tax years after 2018.[31] Under BBA, any adjustment to a partnership-related item ("PRI"), which is defined as any item or amount that is relevant in determining the tax liability of any person under Chapter 1 of the Internal Revenue Code, is determined at the partnership level.[32] The BBA regime provides for a general three year period for making adjustments to PRIs.[33] This period can be extended by special circumstances.[34]

The memo observes the unique aspect of the limitation's provisions of the BBA regime; Section 6235 provides a period of limitations for adjustments and not a period of limitations on making assessments. This means that Section 6235 does not affect the period of time to assess a tax attributable to an adjustment of a PRI. The memo explains that under BBA, an extension per Section 965(k) does not automatically extend the IRS ability to make an adjustment under Section 6235.

However, there are circumstances that extend the period for making an adjustment. These are contained in Section 6235(c)(2) which provides for an extended adjustment period if the partnership omits from gross income amounts includible as described in subparagraph (a) or (c) of Section 6501(e)(1).[35]

The memo addressed how the BBA rules interact with the three major Section 965 adjustment categories. For adjustments to Section 965(a) inclusions, the IRS would have six years to make an adjustment because they are gross income required to be included under Section 951(a).[36] Because Section 965(c) deduction amounts and Section 965(c) deductions are not gross income, they are not required to be included under Section 951(a). Therefore, if the partnership fails to properly include a Section 965(c) deduction amount or Section 965(c) deduction, such failure would not result in the application of the special rule under Section 6235(c)(2) which would mean that the IRS would have three years to make adjustments to the partnership for that taxable year (assuming no other special rules applied).

Lastly, the memo addresses scenarios in which a taxpayer under BBA fails to furnish required information to the IRS as described in Section 6501(c)(8). In these cases, Section 6235(C)(2) provides a period of limitations on making

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[29] IRC § 6229(a)
[30] *See Rhone-Poulenc Surfactants & Spec., LP v. Comm'r*, 114 T.C. 533, 550-51 (2000).
[31] IRC § 6221(b)
[32] IRC § 6221(a), Treas. Reg. 301.6241-1(a)(6)(ii)
[33] IRC § 6235
[34] IRC § 6235(c)
[35] IRC § 6235(c)(2)
[36] IRC § 6235(c)

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adjustments shall not expire before the assessment date as determined under Section 6501(c)(8).[37] This could impact taxpayers period of assessment for their Section 965 liability by extending the limitations period to six years.

Period of Limitations for Non-TEFRA/Non-BBA partnerships

There is not a unified method of examining partnerships not subject to either the TEFRA partnership procedures or the centralized partnership audit regime under the BBA. Accordingly, the relevant statute of limitations for making an assessment of tax, including a net tax liability under Section 965, is the partner's applicable statute of limitations under Sections 965(k) and 6501, as applicable, including any applicable suspensions or extensions.

Audio Technica v. United States and the doctrine of judicial estoppel

In *Audio Technica U.S., Inc. v. U.S.*,[38] the Sixth Circuit Court of Appeals reversed the district court with respect to the applicability of the doctrine of judicial estoppel to refund claims filed by Audio Technica for research and tax credits ("R&D Credits") for its 2006-2010 years. In other years that were before the United States Tax Court, Audio Technica and the IRS had previously agreed to the resolution of the amount of R&D Credits allowable to Audio Technica. The Sixth Circuit held that the district court had erroneously applied the doctrine of judicial estoppel to preclude the IRS from challenging the amount of Audio Technica's R&D Credits for 2006-2010.

Audio Technica claimed a tax credit for research and development activities under §41, for the years 2002 to 2011. The R&D tax credit that Audio Technica claimed is available to taxpayers that increase certain research expenses over time. Under §41, a taxpayer is entitled to a credit equal to twenty percent of the amount that its qualified research expenses for the year exceed the "base amount."[39] The higher a taxpayer's qualified research expenses that year, and the lower its base amount, the greater the tax credit. The base amount is calculated by taking average gross receipts for the previous four years, this amount is multiplied by the fixed-based percentage which, in general, is by adding up the taxpayer' s total qualified research expenses for all tax years beginning in the five-year period from 1984 to 1988, and then dividing that number by the taxpayer' s aggregate gross receipts for that same period.[40] The lower the taxpayer's fixed-base percentage, the higher its R&D tax credit.

The IRS disagreed with Audio Technica and issued a notice of deficiency with respect to the R&D Credits that it claimed for 2002 through 2005 and for 2011. Audio Technica filed a petition for review with the United States Tax Court ("Tax Court"). Before the case went to trial, Audio Technica and the IRS settled the cases and the settlement was approved by the Tax Court. The settlement did not address the specific details with respect to the calculation of the Audio Technica's R&D Credits, but provided the dollar amount of the agreed deficiencies for 2002 through 2005 and the amount of its R&D Credit for 2011. According to the settlement reached in the Tax Court, these "specific agreements" were calculated according to a fixed-base percentage of .92%.

For the 2006-2010 tax year, Audio Technica decided to sue the IRS in district court for a refund of its R&D Credits, filing a motion *in limine* arguing that the government was judicially estopped from claiming that the .92% fixed-based percentage did not apply in this case. Specifically, Audio Technica said that the IRS had previously agreed to a stipulated settlement with a .92% fixed base percentage and argued that "the doctrines of judicial estoppel and general principles of equity and fairness" required that the government "be estopped from introducing any evidence or asserting a position different than it agreed to in the Tax Court with regard to the Fixed Base Percentage." The district court granted this motion, holding that because the government had agreed to the percentage in the settlements "and because these settlements were 'accepted and signed by the Tax Court,' the government was barred from arguing that another percentage might apply in this case."[41]

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[37] IRC § 6235(C)(2)
[38] *Audio Technica U.S., Inc. v. United States*, No. 19-3469 (6th Cir. 2020)
[39] IRC § 41(a)(1)
[40] IRC § 41(c)(3)(A)
[41] *Audio Technica U.S., Inc. v. United States* No. 19-3469, 4 (6th Cir. 2020)

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The government appealed the case to the Sixth Circuit raising the issue of whether the district court erred in holding that the IRS was judicially estopped from challenging the .92% fixed-base percentage utilized by Audio Technica for its R&D Credits claimed in 2006 through 2010. The government argued that the district court erred because the court order memorializing a settlement agreement does not constitute judicial acceptance of the facts underpinning the agreement and in either case (2002-2005 or 2011), the fixed based percentage was not specified in the agreements between the parties.

The Sixth Circuit reviewed the question *de novo* and noted: "The doctrine of judicial estoppel bars a party from: (1) asserting a position that is contrary to one that the party has asserted under oath in a prior proceeding, where (2) the prior court adopted the contrary position 'either as a preliminary matter or as part of a final disposition.'"[42] The court observed that the animating principle behind the doctrine is to protect the integrity of the judiciary from a party trying to convince two different courts to adopt contradictory positions.[43]

The court found that judicial estoppel cannot apply in this case because the Tax Court litigation was resolved through a settlement, meaning there was no judicial acceptance of the government's position. Citing Sixth Circuit precedent, the court noted that settlements do not constitute judicial acceptance of the settlement terms. The court rejected Audio Technica's reliance on *Reynolds v. Commissioner*, a case that applied judicial estoppel to terms asserted in a settlement that was approved by the bankruptcy court.[44] The court distinguished *Reynolds* from the current case as distinct because of the unique nature of bankruptcy settlements, where agreements are examined by courts to protect the interests of third parties.

Furthermore, the court found that even if the settlements could have allowed for judicial estoppel, the Tax Court never adopted the fixed-based percentage when it approved the settlement of the case. On these grounds, the Sixth Circuit reversed the district court's order on Audio Technica's motion *in limine* and remanded the case to the district court to determine Audio Technica's fixed-base percentage.

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[42] *Id.* at 7 (citing *Browning v. Levy*, 283 F.3d 761, 775 (6th Cir. 2002) quoting *Teledyne Indus., Inc. v. NLRB*, 911 F.2d 1214, 1218 (6th Cir. 1990)
[43] *Id.*
[44] *Reynolds v. Commissioner*, 861 F.2d 469 (6th Cir. 1988)

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